IN THE COURT OF APPEAL OF THE DEMOCRATIC SOCIALIST REPUBLIC OF SRI LANKA

In the matter of an Appeal by way of Stated Case on questions of law for the opinion of the Court of Appeal under and in terms of Section 11A of the Tax Appeals Commission Act, No. 23 of 2011 (as amended)

Case No: C.A. (Tax) 21/2022
Tax Appeal Commission No: TAC/IT/106/2017

Colombo Fort Land and Building PLC,
8-5/2, Leyden Bastian Road,
York Arcade Building,
Colombo 01.

APPELLANT

-Vs-

Commissioner General of Inland Revenue,
Department of Inland Revenue,
Sir Chittampalam A. Gardiner Mawatha,
Colombo 02.

RESPONDENT

Before: S. U. B. Karalliyadde, J.

Mayadunne Corea, J.

Counsel: Suren Fernando with Kyati Wickramanayake instructed by Vidanapathirana Associates for the Appellant.

Ms. Chaya Sri Nammuni, DSG for the Respondent.

Written submissions tendered on:

30.10.2023 and 04.06.2024 by the Appellant.

28.11.2023 and 10.07.2024 by the Respondent.

Argued on: 21.02.2024 and 01.04.2024

Decided on: 24.10.2024

S. U. B. Karalliyadde, J.

The Appellant in the instant case stated The Colombo Fort and Building PLC is a public limited liability company incorporated in Sri Lanka. By the letter dated 26.11.2013,[1] it has submitted the tax return for the assessment year 2012/2013. The Assessor, by the letter dated 07.09.2015[2] informed the Appellant that the tax return cannot be accepted for the reason that the Appellant is engaged in the business of investing shares in companies and therefore as dividend and interest income of the Appellant company being an investing company should be treated as a part of trading profit as per Section 3(a) of the Inland Revenue Act, No. 10 of 2006 (the Act).

The Appellant received the Notice of Assessment dated 12.11.2015[3] and by the letter dated 09.12.2015[4], the Appellant appealed against it to the Commissioner General of Inland Revenue (the Respondent) against the said assessment. The Respondent by his determination dated 17.11.2017[5] confirmed the said assessment. Being aggrieved by the said determination of the Respondent, by the Petition dated 26.02.2018 the Appellant appealed to the Tax Appeals Commission (the TAC). The TAC by its

[1] at page 82 of the appeal brief.

[2] at page 86 of the appeal brief.

[3] at page 87 of the appeal brief.

[4] at page 92 of the appeal brief.

[5] at page 01 of the appeal brief.

determination dated 04.04.2022,[6] confirmed the decision of the Respondent. It is against the said determination of the TAC, the Appellant requested the TAC to state a case on the following questions of law for the opinion of this Court in terms of Section 170(6) of the Act.

i. Is the Assessment (and the determination of the Commissioner General, and the determination of the Tax Appeals Commission pursuant to same) liable to be quashed and/or annulled inasmuch as the Assessor purporting to assess the Appellant and/or issuing Notice of Assessment on the Appellant was not the Assessor who purported to provide 'reasons' therefor?

ii. Is the Assessment, (and the determination of the Commissioner General, and the determination of the Tax Appeals Commission pursuant to same) liable to be quashed and / or annulled inasmuch as the Assessor failed to duly provide reasons for the Assessment as required by Section 163(3) of the Inland Revenue Act No. 10 of 2006 (as amended)?

iii. Did the Assessor, the Commissioner-General, and the Tax Appeals Commission, err in law in failing to recognize that the Appellant functioned as a Holding Company as opposed to an Investment Company?

iv. Was the interest earned by the Appellant liable to be considered as 'income' within Section 3(e) of the Inland Revenue Act No. 10 of 2006 (as amended), and NOT within Section 3(a) of the said Act?

[6] at page 266 of the appeal brief.

v. Did the Assessor, the Commissioner General, and the Tax Appeal Commission, err in law in falling to give due credit in respect of withholding tax paid by the Appellant in respect of interest received?

vi. Were the dividends earned by the Appellant, in the first instance, liable to be considered as 'income' within Section 3(e) of the Inland Revenue Act No. 10 of 2006 (as amended), and NOT within Section 3(a) of the said Act?

vii. Did the dividends earned by the Appellant not form part of its statutory income in view of the provisions of Section 63 of the Inland Revenue Act No. 10 of 2006 (as amended)?

viii. Is the Assessment, (and the Determination of the Commissioner General, and the Determination of the Tax Appeals Commission, thereon) contrary to law?

ix. In view of the evidence and material before the Tax Appeals Commission, did the Tax Appeals Commission err in law in arriving at the conclusions set out in its determination?

This Court addresses the questions of law as follows.

Question of Law I

Is the Assessment, (and the determination of the Commissioner General, and the determination of the Tax Appeals Commission pursuant to same) liable to be quashed and / or annulled inasmuch as the Assessor purporting to assess the Appellant and/or issuing Notice of Assessment on the Appellant was not the Assessor who purported to provide 'reasons' therefor?

The Appellant has drawn the attention of the Court that the letter of intimation dated 07.09.2015[7] which sets out the reasons for the assessment has been issued by the Assessor S. T. Dissanayake but the Notice of Assessment dated 12.11.2015[8] bears the seal of G. A. W. Abeywardena, who is an Assistant Commissioner. The learned Counsel appearing for the Appellant argued that in terms of Section 163(3) read with Section 164 of the Act, the same person who issues the Notice of Assessment should make the assessment and communicate the reasons for not accepting the tax return. The learned DSG appearing for the Respondent argued that the letter of intimation includes the assessment and under Section 163(3) the Assessor's task is to assess the person and communicate the reasons for not accepting the tax return. Therefore, Assessor S. T. Dissanayake has acted according to the law by signing the assessment sheet dated 30.09.2015[9] and issuing the letter of intimation dated 07.09.2015[10]. The learned DSG further argues that the Notice of Assessment issued under Section 164 is a computer-generated document and a ministerial task. Therefore, the Notice of Assessment and the letter of intimation need not be sent by the same person.

Refusing to accept the said argument of the Appellant, the TAC in its determination has held that, when an Assistant Commissioner does not accept the tax return for a particular year of assessment, under Section 163(3) of the Act, the Assistant

[7] at page 86 of the appeal brief.

[8] at page 87 of the appeal brief.

[9] at page 242 of the appeal brief.

[10] at page 86 of the appeal brief.

Commissioner will make an assessment and communicate the reasons for such non-acceptance in writing and it is not mandatory for the Assistant Commissioner who made the assessment to send the Notice of Assessment under Section 164.

In the case of *Carbotels (Private) Limited vs. Commissioner General of Inland Revenue*[11] where this Court dealing with the same question of law, held that the assessment is not bad in law merely for the reason that the Assessor who issued the Notice of Assessment is not the same Assessor who made the assessment and communicated the reasons for making such assessment. In this case, this Court observed that,

> *"In the instant case, communication of the reasons of the Assessor has taken place albeit the notice of assessment is not issued by the same Assessor who made the assessment and communicated his reasons for the same. However, when the purpose of this practice is observed, it is clear that in the instant case, the Assessor, one M.M.O. Wijesuriya, has done what was required of him by giving his mind to the return and making a definite determination not to accept it. He has communicated his reasons for arriving at his decision to the Appellant. No prejudice could be said to have been caused to the Appellant."*

In the case at hand, it is clear that Assessor S. T. Dissanayake had assessed and communicated the reasons for such assessment in terms of Section 163(3) by placing

[11] CA/TAX/11/2016, CA Minutes of 25.05.2022.

her signature on the assessment sheet dated 30.09.2015 and by issuing the letter of intimation communicating the reasons for such assessment.

Considering the above-stated facts and circumstances this Court is of the opinion that the Assessor who assesses and communicates the reasons for such assessment need not be the same person who issues the Notice of Assessment and therefore, this Court answer the first question of law in the negative and favour of the Respondent.

Question of Law II

Is the Assessment, (and the determination of the Commissioner General, and the determination of the Tax Appeals Commission pursuant to same) liable to be quashed and / or annulled inasmuch as the Assessor failed to duly provide reasons for the Assessment as required by Section 163(3) of the Inland Revenue Act No. 10 of 2006 (as amended)?

It is the argument of the learned Counsel for the Appellant that, instead of giving reasons the Assistant Commissioner in the letter of intimation has given conclusions. The learned Counsel for the Respondent contends that the reasons given by the Assistant Commissioner are sufficient for the Appellant to prefer an appeal. The Respondent relied on the case of *Mrs E D Gunaratne vs. Jayawardena and others*[12] where it was held that a clue is given as to where the taxpayer had gone wrong in his return and the reason given is adequate and intelligible to enable him to formulate his grounds to appeal to the Commissioner.

[12] Ceylon Tax Cases Vol 1 at page 246.

In the instant case the TAC in its determination has observed that, "*since the Appellant has formulated the grounds of appeal, it indicates that the Appellant has understood under what reasons the Assistant Commissioner has rejected the returns of income. In this matter, we see that no prejudice has been caused as the Appellant had appealed to the Respondent for the said decision of the Assistant Commissioner. If the Appellant did not get proper reasons explaining the refusal of the income tax return by the Assistant Commissioner, they would not be able to make a valid appeal.*"

In the letter of intimation, by quoting the Memorandum of Association and Auditors Report, the Assistant Commissioner has clearly stated that the reason for not accepting the tax return is that the Appellant is engaged in the business of investing shares of the companies and such dividend and interest income should be treated as a part of trading profit under Section 3(a) and not as a separate source of income.

Therefore, this Court is of the opinion that an adequate reason has been given by the Assistant Commissioner in the letter of intimation enabling the Appellant to prefer an appeal to the Commissioner. Thus, this Court answered the second question of law in the negative in favour of the Respondent.

Question of Law III

Did the Assessor, the Commissioner-General, and the Tax Appeals Commission, err in law in failing to recognize that the Appellant functioned as a Holding Company as opposed to an Investment Company?

The position of the Commissioner General and the TAC is that the Appellant is an investment company and therefore, the dividend and interest received by it forms "business income" in terms of Section 3(a) of the Act. In deciding that the Appellant is an Investment Company as opposed to a Holding Company, the Respondent relied on the fact that the number of companies in which the Appellant has invested changes from year to year and out of the companies it held shares, it had more than 50% shares only in two companies.

The Appellant relied on the interpretation provided in Section 529 of the Companies Act, No. 7 of 2007 and argued that the Appellant is a holding company.

"holding company", a company shall be deemed to be another company's holding company, if and only if that other company is its subsidiary. For the purpose of this definition "company" includes anybody corporate;

"subsidiary", a company shall be deemed to be a subsidiary of another, if and only if—

(a) that other company either-

(i) controls the composition of its board of directors;

(ii) is in a position to exercise or control the exercise of more than half the maximum number of votes that can be exercised at a meeting of the company;

(iii) hold more than half of the issued shares of the company, other than shares that carry no right to participate beyond a specified amount in a distribution of profits or capital;

(iv) is entitled to receive more than half of every dividend paid on shares issued by the company, other than shares that carry no right to participate beyond a specified amount in a distribution of profits or capital; or

(b) the first-mentioned company is a subsidiary of any company which is that other company's subsidiary.

Furthermore, the Appellant argues that in the nature of investment companies, the shares are bought and sold within a short duration to make trading profits as opposed to capital gains, whereas in the instant dispute, the Appellant only received dividends and, capital gains at the time of disposal of the shareholding of each subordinate company. The Appellant relied on the case of *Janashakthi Securities Ltd vs. Commissioner General of Inland Revenue*[13] and argued that this Court has decided in that case that the Appellant Company as an investment company on the basis that the company was incorporated to carry on the business of investment and the company invested in government securities such as treasury bonds and treasury bills on a continuous basis. There were 240 transactions of that nature in the relevant year and the income was derived from these trading transactions. I observe that the Appellant company in the present case is not incorporated for such purpose but rather, to engage in business in real estate and property development, management of an investment portfolio and provision of management services. Further, the Appellant has not been engaged in investing in the shares of the subordinate companies on a continuous basis

[13] CA/Tax/10/2009, CA Minutes of 17.07.2013

but rather was holding the shares for long durations which resulted in receiving dividend income over a period of time.

In the case of *CEI Plastics Limited vs. Commissioner General of Inland Revenue*[14], the criteria followed was that,

> *"There had been* ***repetitive shareholding transactions*** *which had been* ***carried on systematically in an organized manner****. These facts in my view establish that the share trading activity referred to by the Appellant constituted a "business" within the meaning of Section 3(a) of the Act."*

This Court is of the opinion that there had not been such repetitive transactions on investment in shares, hence that does not constitute a "business" in terms of Section 3(a) of the Act. Even though there has been a repetitive receipt of dividend income over time, since such income is not generated by the principal business activity of the Appellant, it should not be considered taxable income under Section 3(a). Furthermore, this Court observes that the Appellant company has been controlling the subsidiary companies through shareholding and the Appellant has held more than 50% of the shares of the companies directly or indirectly as a group of companies.[15] Therefore, it is the view of this Court that the Appellant company is functioning as a holding company rather than an investment company.

[14] CA/Tax/03/2013, CA Minutes of 02.01.2019.

[15] at page 205 of the appeal brief.

Based on the above circumstances, I am of the view that the Commissioner General of Inland Revenue and the TAC have erred in law in failing to recognize that the Appellant company functions as a Holding Company as opposed to an Investment Company. I answer the third question of law in the affirmative and in favour of the Appellant.

Question of Law IV

Were the interests earned by the Appellant in the first instance, liable to be considered as "income" within Section 3(e) of the Inland Revenue Act, No. 10 of 2006, and not within Section 3(a) of the said Act?

Question of Law VI

Were the dividends earned by the Appellant in the first instance, liable to be considered as "income" within Section 3(e) of the Inland Revenue Act, No. 10 of 2006, and not within Section 3(a) of the said Act?

The Court will address the fourth and sixth questions of law together as follows.

The Respondent submitted that the dividend and interest income is the principal source of income of the Appellant and therefore it should be treated as business income of the company in terms of Section 3(a) of the Act. However, this Court observes that the objective of incorporation of the Appellant company is to engage in business in real estate and property development, management of an investment portfolio and provision of management services, which does not include investment in shares and dividends as a form of business activity.

Further, the position of the Respondent is that the dividend income from the subsidiaries forms the major part of its income. The learned DSG appeared for the Respondent submitted in her oral submissions that 82%-87% of the income of the Appellant company derives from such dividend income and argued that if the dividend income is exempted from tax, only a minute portion of the total income would be liable to taxation. Therefore, such dividend income should be considered as business income in terms of Section 3(a) of the Act. As reflected in the third question, the Appellant is a holding company and not an investment company. Hence considering the main purpose of incorporating the company, I am of the view that the dividend income does not constitute profits or income from its business under Section 3(a).

Furthermore, this Court observes that the dividend income can be recognized as a separate income from the primary income of the Appellant.[16] Therefore, dividend income should be recognized under Section 3(e) and not under Section 3(a) of the Act. In *Kanagasabhapathi vs. Commissioner General of Inland Revenue*[17], it was observed that *"in tax cases, it is always necessary to remind oneself that when it is sought to impose a tax on the subject, the burden is always on the revenue authorities to prove that tax is exigible.".* The CGIR has failed to demonstrate that the dividend and interest earned by the Appellant company has derived from the source of profit and income defined in Section 3(a) of the Act.

[16] at page 13 of the appeal brief.

[17] Sri Lanka Tax Cases, Vol. IV, p.140.

For the above reasons I am of the opinion that the Appellant is a holding company, and the dividend and interest income earned by the Appellant in the first instance, is liable to be considered as "income" within Section 3(e) of the Act and not within Section 3(a) of the Act. I answer the fourth and sixth questions of law in the affirmative and in favour of the Appellant.

Question of Law V

Did the Assessor, the Commissioner General, and the Tax Appeal Commission, err in law in falling to give due credit in respect of withholding tax paid by the Appellant in respect of interest received?

Question of law VII

Did the dividends earned by the Appellant not form part of its statutory income in view of the provisions of Section 63 of the Inland Revenue Act No 10 of 2006?

The Court will address the fifth and seventh questions of law together as follows.

The position of the learned DSG appearing for the Respondent is that since the dividend and interest income of the Appellant company should be treated under Section 3(a) of the Act, the exemption in Section 63 is not applicable for the reason that it exempts the dividend income under Section 3(e). The learned DSG argues that the explicit exemption for the dividend income recognized under Section 3(a) is in terms of the Inland Revenue (Amendment) Act, No. 9 of 2015, which is not recognized for the accounting year of 2012/2013. The learned Counsel for the Appellant submitted that as per Section 63 of the Act (amended), the exemption must be available to any dividend

income, and not only the dividend classified in Section 3(e) of the Act but also Section 3(a) and in any event, the dividend income falls under Section 3(e) of the Act as the Appellant is a holding company. Section 63 of the Act reads as follows.

Where a dividend is paid by any resident company to any resident or non-resident company, and either—

(a) a deduction has been made under section 65 in respect of that dividend by the first-mentioned resident company;

(b) that dividend is exempt from income tax under Section 10;

(c) such dividend consists of any part of the amount of a dividend received by the first-mentioned resident company from another resident company; or

(d) such dividend is a dividend declared by a quoted public company,

profits and income from such dividend shall, notwithstanding anything to the contrary in any other provision of this Act, be deemed not to form part of the total statutory income of the second-mentioned company.

For the purpose of this section the profits and income from such dividends which form part of the profits under section 3(a) of this Act, means profits and income after deducting expenses in ascertaining the profits from such business of receiving dividends.

The learned Counsel for the Appellant submitted that the legislature intends to prevent the same subject from being taxed at multiple stages of the same tax chain. When a company generates profits, the tax is charged by way of corporate tax, and when

distributing the dividends, the subsidiary company pays withholding tax. The argument of the learned Counsel for the Appellant is that charging tax from the Appellant on dividends in this set-up where the subsidiary companies have already paid the tax amount to double taxation.

The position of the learned DSG for the Respondent is that, as argued in Questions of Law numbers III, IV and VII the dividend and interest income should be recognised under Section 3(a), however, the exemption for dividend income was introduced to Section 63 only after the Amendment Act, No. 9 of 2015. The learned Counsel appearing for the Appellant argued that the explicit exclusion of Section 3(a) under Section 63 is a mere clarification provided, all forms of dividend income has been exempted from tax under the Act. Therefore, regardless of which subsection the income has been recognized, it should be excluded. This Court observes that the literal interpretation of the legislature has not excluded the dividend income under Section 3(a). In the case of *John Keells Holdings PLC vs. Commissioner General of Inland Revenue*[18] which discussed a similar issue on exemption of dividend income under Section 63, Samarakoon, J. held that,

> *"It may be noted, that this amendment in 2015 is referred to not because it applies to the years of assessment in question in this case, but because it shows the intention of the legislature to apply section 63 even if the dividend income is classified under section 3(1)(a).*

[18] TAX 26/2013, CA Minutes on 16.03.2022

Hence it appears that the amendments in 2014 and 2015 have a further purifying effect on the principle embodied in section 63 of the Act."

Further, the Respondent argues that the dividend income of the company is approximately 71% of its revenue and it would be impractical to exclude a major part of income from tax liability. However, this Court is of the view that if the statute does not provide for a tax liability, this Court cannot impose such beyond the letter of law.

In *Partington vs. Attorney General*[19] Lord Cairns said,

"If the person sought to be taxed comes within the letter of the law he must be taxed however great the hardship may appear to the Judicial mind to be. On the other hand, if the Crown seeking to recover the tax cannot bring the subject within the letter of the law the subject is free however apparently within the spirit of the law the case might otherwise appear to be. In other words, if there be admissible in any statute what is called an equitable consideration certainly such a construction is not admissible in a taxing statute where you can simply adhere to the words of the statute".

Hence as it was mentioned hereinbefore, there is no equity in a tax. Further, in *W T Ramsay vs. CIR*[20] Lord Wilberforce held that,

"A subject is only to be taxed upon clear words not upon "intendment" or upon the "equity" of an act".

[19] (1969) LR 04 HL 100 at page 122.

[20] [1981] 1 All E R 865.

In the case of *Ceylon Financial Investments vs. Commissioners of Income*[21] Howard CJ held that,

> *"for the enumeration of sources, we must turn to section 6 (1). Can it be said that these sources like the Schedules in England are mutually exclusive? The wording of sources (a), (b) and (c) shows that these sources are mutually exclusive. (d) excludes (a), (b) and (c), and (h) excludes all previous sources. But there are no words in (e) to show that this source does not apply to dividends, interest or discounts arising from a trade or business.* ***If the business of a company consists in the receipt of dividends, interest or discounts alone*** *or if such a business can be clearly separated from the rest of the trade or business, t****hen any special provisions applicable to dividends, interest or discounts must be applied****"*

Samarakoon J. in the *John Keells Holdings PLC* case(supra) analysed the case of *Ceylon Financial Investments vs. Commissioners of Income*(supra) which the Respondent heavily relied on in the present case in great detail and concluded that,

> *"The majority of the 05 judge Bench classified the appellant in that case under source (e) as well as source (a) and also decided that any special provision applicable to dividends, etc., must apply."*

Based on the above-mentioned circumstances, I am of the view that the CGIR has failed to interpret Section 63 accurately and the dividends earned by the Appellant do not form part of its statutory income in view of the provisions of Section 63 of the Inland

[21] Ceylon Tax Cases, Vol I, page 235.

Revenue Act No 10 of 2006 and that income should be exempted. I answer the fifth and seventh questions of law in the affirmative and in favour of the Appellant.

Question of law VIII

Is the Assessment, (and the Determination of the Commissioner General, and the Determination of the Tax Appeals Commission, thereon) contrary to law?

Question of law IX

In view of the evidence and material before the Tax Appeals Commission, did the Tax Appeals Commission err in law in arriving at the conclusions set out in its determination?

Considering the above-stated opinion of this Court, I answer the eighth and ninth questions of law in the affirmative and in favour of the Appellant.

For all the foregoing reasons, the Court answers the questions of law in the Stated Case as follows,

1. No

2. No

3. Yes

4. Yes

5. Yes

6. Yes

7. Yes

8. Yes

9. Yes

Under the above-stated circumstances, the appeal in the form of a Case Stated is allowed.

JUDGE OF THE COURT OF APPEAL

Mayadunne Corea, J.
I agree.

JUDGE OF THE COURT OF APPEAL